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ECONOMIC POLICYMAKING: THE NEPAL EXPERIENCE

November, 1995

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Working Paper No. 182

This publication was made possible through support provided by the U.S. Agency for International Development, under Cooperative Agreement No. DHR-0015-A-00-0031-00 to the Center on Institutional Reform and the Informal Sector (IRIS) and administered by the Office of Economic and Institutional Reform, Center for Economic Growth, Bureau for Global Programs, Field Support and Research.

The views and analyses in the paper do not necessarily reflect the official position of the IRIS Center or the U.S.A.I.D.

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EXECUTIVE SUMMARY

Introduction

- o. Nepal has come a long way during the last four years in its drive to attain a private-sector led competitive market economy. The focus of this paper is to relate our experiences on policymaking and describe the lessons we learnt regarding the process of economic reform;
- o. Our experiences were gained through the Economic Liberalization Project of USAID which assisted the Government of Nepal design and implement many of the market reform measures that were undertaken during the four years. The major initiatives that were channelled through the Project included privatization of public enterprises, preparatory work on the Value Added Tax, tax reforms (income tax, octroi, property tax), establishment of the Trading Floor at the Nepal Stock Exchange, legal reform, simplification of industry registration procedures, and help with airline fare deregulation. Most of these initiatives were undertaken during the period when the Nepali Congress Government, headed by Prime Minister G.P. Koirala, was in power.

Factors Contributing to Sustained Policy Reform

- o. There are perhaps very few as frequently used cliches as "economic compulsion", "political will", "bureaucratic commitment", and "technical know-how" when discussing sustainability of economic reform. It would be naive to assume that factors relevant for sustained policy reform in Nepal would be very different from those in any other country;
- o. A severe economic crisis is often cited as the primary pre-requisite for comprehensive policy reform in any country. Though Nepal was not beset with severe macroeconomic problems, India--faced with a balance of payments crisis--had started to open up in the early 1990's. Nepal, as a small country with an open border with her southern neighbor, had little choice but to keep pace with the reform initiatives in India: during budget preparation at the Ministry of Finance, the initial focus was always on the levels of tariffs and subsidies in India and the extent to which the forthcoming Nepali budget had to counter them;
- o. That "political will" is a necessary pre-condition for sustained economic reform is well-established. In the case of Nepal, political will was manifested in the

determination of Prime Minister Koirala to push ahead with structural reform despite opposition from some members of the Council of Ministers as well as Nepali Congress Party officials. Koirala was guided by the notion that politically unpopular decisions that required trading short-run pains for long-run gains could be best done in the first three years of his tenure;

- o. The importance of bureaucracy to the reform process cannot be minimized. A few technocrats well-placed in the Administration and reasonably well-versed about the reform process have to take the lead. In Nepal, three technocrats--P.R. Ligal, Member of the National Planning Commission, T.N. Pant, Secretary of Finance, and H.S. Tripathi, Governor of Nepal Rastra Bank--were crucial to the sustenance of the reform process. Without co-ordination among these three and their institutions, the economic reform process would have been very difficult to sustain;
- o. Technical assistance, especially from donors, is important to the reform process in many respects. The Government of Nepal, for instance, used such expertise as a sounding board for possible reform initiatives. Besides, the Government would have found it difficult to push ahead with reform, especially new initiatives like the Value Added Tax and privatization of public enterprises, if such assistance was not forthcoming.

Factors Impeding the Reform Process

- o. Political stability is a pre-requisite for sustained policy reform. Policy reform involves many unpopular decisions, and unless a country has political stability, it is difficult for the Government to pursue economic liberalization. With a majority in Parliament, the Nepali Congress was able to initiate structural reform programs in a comprehensive manner; with a minority Government susceptible to ouster, the Communists were unable to take bold economic reform initiatives;
- o. Political stability also affects a country's ability to attract foreign investments. More than 50 percent of the foreign investors that came to Nepal in the last twenty years was in a period of 36-months when the Nepali Congress was in power. Foreign investments have come to a virtual halt since the announcement of mid-term polls in July 1994 and the election of a hung Parliament later in November. A capital and technology poor country like Nepal cannot sustain the reform process without the flow of funds and technical know-how from overseas;
- o. Economic reform has to be broad based and convincingly communicated for it to attain sustainability. The communications effort has to come on a number

of fronts. The Nepali Congress Government was struggling to convince a majority of its own Parliamentarian that state-dictated socialism was passe. Moreover, not much was done to educate the public about the long-term gains of liberalization and generate a strong national consensus on the need for economic reform;

- o. The lack of proper legal and market institutions can be an imposing hurdle to the reform process. While many of the legal and market institutions needed for market reform existed in Nepal, the institutions so developed were archaic, out of step with the modern economy, not business friendly, and promoted rent seeking. Moreover, rules and regulations that supported the various legislations were lacking in transparency. And, even in cases where rules and regulations existed, the administrative structure was so inefficient that implementation was difficult. Rent-seeking was excessive and it was in the bureaucracy's interest to thwart any reform initiatives.

Lessons in Policy Making

- o. The most important lesson we learnt regarding the process of economic reform is that the drive for policy reform has to come from within the system. Because a lot of inertia has to be expended to overcome the coalition of political opposition and lethargy that block significant changes, it is imperative that key policymakers, decision-makers, and technocrats are comfortable with the proposed changes and are willing to bear the torch of economic liberalization from inception to completion;
- o. For economic reform to be successful on a sustained basis, it has to be broad-based and acceptable to the masses. Hence, economic reforms that involve unpopular decisions may have to be accompanied by other measures that would be more palatable to the public but non-distortionary in nature;
- o. The other element of broad-basing economic reform is having proper public relations. The Nepal experience makes it very clear that there is a need to use mass media and other social marketing techniques to create a significant constituency to support reform. Broad basing also means creating coalitions for reform that include the business community. And, it is important to understand that business consultations are not for political convenience. There should be a genuine give and take where all classes of businesses are taken into confidence;
- o. Consistency in implementation of policy has to exist from the top down. The discipline has to start from the Council of Ministers. If exemptions are to be

granted to certain interest groups, this should be applicable to all. The Government should not be in the business of providing competitive advantage to one business vis-a-vis another--it should be promoting a level playing field;

- o. Implementation at the administrative level has been Nepal's biggest lacuna in the economic reform process. The inability of the Government to provide employees with an incentive based system combined with the lack of authority to hire and fire within the framework of a private sector culture contributed to the problems of implementation. Administrative reform has not been able to cope with the pace of policy advancements. This needs to be resolved soon;
- o. There are four basic lessons on policy reform from a donor perspective: while donor assistance in some form is necessary, conditionalities and technical assistance should come from a mutually respectable negotiating process; donor co-ordination is important given that resources are scarce and duplication of efforts implies inefficiency; donor assistance should be used to create internal advocacy groups so as to sustain the reform process; and, donors themselves should honestly follow-through with their aid commitments if mutually agreed to conditionalities are being met: changing horses in mid-stream can be onerous to a host Government that is pushing a politically unpopular agenda.

ECONOMIC POLICYMAKING: THE NEPAL EXPERIENCE¹

by

Praveen M. Dixit²

Abstract

This paper uses our experiences in the Economic Liberalization Project of USAID to point out factors that have been important to the policy reform process in Nepal during the last four years. We state that political will of the Nepali Congress Government was perhaps the most crucial element in sustaining the reform process once economic compulsion made it necessary. Conversely, political instability brought on by the midterm polls has been the most damaging impediment to the country's development process. Among the lessons we learned, host country nationals have to have a strong sense of ownership of reform. Similarly, broad basing reform is also crucial to the sustenance process. Nepal is currently at a cross-road between policy reform and populist electoral promises. Will the next Government have the courage to discount short-run costs for long-run gains?

¹ Paper presented at the Patan Rotary Club, Lalitpur, Nepal, August, 21 1995.

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ECONOMIC POLICYMAKING: THE NEPAL EXPERIENCE¹

I. Introduction

Few would argue against the contention that Nepal has come a long way during the last four years in its drive to attain a private-sector led competitive market economy. In a paper elsewhere (Dixit, 1995)², I have described the reforms undertaken by the Nepali Government during the period and prescribed policies and other measures that they might consider pursuing over the next few years.

In this paper, my focus is to relate our experiences on policymaking and describe the lessons we learnt regarding the process of economic reform. Our experiences were gained through the Economic Liberalization Project of USAID which assisted the Government design and implement many of the market reform measures that were undertaken during the last four years. While these observations are those of an individual assigned to a particular project in a specific country, the lessons learnt from these experiences are probably applicable to a wide variety of situations and nations where donor assistance is sought in advancing the economic reform process.

Economic policy-making can include decisions at different levels of hierarchy. Our emphasis in this paper is on macro level decisions, especially those directly affecting economic management, stability, and structural reform. This is not to suggest that other decisions, especially those that involve specific projects or interest groups, are not important; just that such micro-level decisions are more easily discussed in the context of implementing existing rules and regulations, and not in isolation.

This paper describes our experiences regarding the policy reform process in Nepal during the last three and a half years, starting with October 1992. For much of this period, the Nepali Congress Government headed by Prime Minister G.P. Koirala was in power. In December 1994, the Communist Party of Nepal-United Marxist Leninist (CPN-UML) Government took office with Man Mohan Adhikari as Prime Minister. But, within six months of coming into power, the Lower House of Parliament was dissolved and a caretaker Government established. The CPN-UML Government, therefore, did not get much time to enunciate and implement its economic policy. As such, most of our focus in this paper is on the process of reform during the time the Nepali Congress

¹ The author would like to thank Christopher Clague, Robin Sharma, Anita Tuladhar, and Narendra Basnyat for their comments on an earlier version of the paper as well as acknowledge the contributions of Neal Cohen, USAID/Nepal's Mission economist, to the policy dialogue process.

² Complete citation is listed in **References**

was in Government.

The paper is structured into six parts. We begin with a brief description of the Economic Liberalization Project of USAID and where it fit into Nepal's economic reform process. Then, we talk about factors or pre-requisites that were important contributors to the reform process, both from an initiation and sustenance perspective. This is followed by a discussion of factors that were major impediments to the reform process. Next we highlight the lessons learnt from the Nepal experience. We conclude with a wrap-up of our experiences and a brief outlook on where Nepal's economic reform agenda may be headed.

II. The Economic Liberalization Project

The basis of our policy experience is the Economic Liberalization Project, or ELP as it has come to be known. ELP is an agreement signed in 1991 between the Government of Nepal and USAID to assist policymakers and businesses in the development of a private sector led competitive market economy.

ELP works through two steering Executive Committees, the Policy Dialogue Committee (PDC) and the Business Development Committee (BDC). The PDC is chaired by the National Planning Commission Member in-charge of macro-economic and industry policy. Other permanent members include officials from the Nepal Rastra Bank (Central Bank), the Ministry of Finance, the Ministry of Industry, the Ministry of Commerce, the Business Development Committee, and USAID. The BDC is chaired by a representative of the Federation of Nepalese Chamber of Commerce and Industries (FNCCI)³ and consists of representatives from various commodity associations, the PDC, and USAID. Invitees are brought into these committees as and when needed. Both Committees work with USAID to review, assess, and decide what initiatives ought to be undertaken by the Project.

Policy initiatives come under the domain of the PDC. The Committee, scheduled to meet once a month, performed two basic functions: provided a sounding board for ideas on policy reform, and rendered a medium for providing technical assistance on policy reform. Once technical assistance was agreed to, a client Ministry was identified and it was the responsibility of the concerned PDC member to push the policy agenda through Government. During the three years of the Nepali Congress Government, the major reform initiatives that were channelled through the PDC included privatization of public enterprises, preparatory work on the Value Added Tax

³ FNCCI is the leading spokesman for business in Nepal. The President of the FNCCI has chaired the BDC for the last two years.

(VAT), tax reforms (income tax, octroi, property tax), establishment of the Trading Floor at the Nepal Stock Exchange, assistance with current account convertibility, legal reform (Company Law, Contract Law, Consumer Protection Legislation, BOT Legislation), simplification of industry registration procedures, and help with airline fare deregulation. There were also other smaller initiatives associated with export procedures, capital market development, foreign investment restrictions, and relocation of the carpet industry outside Kathmandu Valley. Not all these initiatives have been carried to fruition.

As part of its technical assistance program, the Economic Liberalization Project uses expatriate consultants to help Nepal's policy reform process. Some of them are brought in for short-term assignments, while others are on a long-term basis. I came into the project in October 1992 through the IRIS Centre of the University of Maryland to "work closely with the Policy Dialogue Steering Committee to achieve the goals of ELP, ...to increase understanding of the economic and policy concepts involved in economic liberalization,...and to advise governmental officials with respect to ELP activities." To achieve these functions, I was invited to attend all PDC steering committee meetings and also designated as Economic Advisor to the Ministry of Finance where I spent part of the day. The Ministry of Finance, for much of my tenure, gave me more or less complete access to most decision-making that involved structural reforms. This access allowed me to be a part of the decision-making process as well as gave me the unique privilege to follow-up on the various reform efforts being initiated through the project.

III. Factors Contributing to Sustained Policy Reform in Nepal

There are perhaps very few as frequently used cliches as "economic compulsion", "political will", "bureaucratic commitment", and "technical know-how " when discussing sustainability of economic reform. These cliches have been around for a long time and have formed the basis for many papers on lessons in policy reform. It would be naive to assume that factors relevant for sustained policy reform in Nepal would be very different from those in any other country: behaviour of interest groups driven by protectionist policies and opposed to changes are likely to be somewhat analogous across societies. But how important were each of these factors in the Nepali context? The attempt here is to use our ELP experiences to go beyond the cliches and explain the relevant economic, political, and sociological arguments that formed the basis for policy reform initiatives in Nepal during the last four years.

Economic Compulsion

A severe economic crisis is often cited as the primary pre-requisite for comprehensive policy reform in any country. Such crises precipitate and make it politically easy to

accept policy changes that are often difficult to swallow. Richard Bird (1992), writing about tax reform in Latin America, states that "acute political and economic crisis provided an occasion for reversing existing policies...countries not teetering on the brink of disaster may be less willing to contemplate quick and drastic reforms." Such seems to have been the case for a large number of Asian, African, and Latin American countries that initiated structural reform programs, including India, Pakistan, Brazil, Argentina, and Ghana. All these countries ran into problems with macroeconomic management (accelerating inflation, burgeoning fiscal deficits, or deteriorating balance of payments) and were compelled to reverse the direction of their prevalent policies.

The situation in Nepal, to some extent, was no different. Though Nepal was not beset with severe macroeconomic problems in the early 1990's, India--faced with a balance of payments crisis--had started to open up. Nepal, as a small country with an open border and a fully convertible currency against the Indian Rupee, had little choice but to keep pace with her southern neighbor. The Minister of Finance, in his FY 1992/93 budget speech, noted "...it is virtually impossible for a small and developing country to progress by remaining outside the bound of the world economy. This is the bitter truth..." (Ministry of Finance, 1992).

In February 1992, India introduced partial convertibility of its currency for current account transactions. Nepal, in order to prevent loss of export competitiveness and capital flight, followed suit almost immediately. A year later, with international reserves burgeoning and inflation in single-digit, the Government pre-empted India and announced full convertibility of the Nepali Rupee for current account transactions. This one move had far-reaching consequences for traded goods: import licenses were subsequently eliminated and subsidies on petroleum products greatly reduced. From then on, the issue was sustaining the pace of reform rather than worry about initiating the process.

How important has external economic conditions been to Nepal's liberalization

The Budget Process

The Budget Statement presented by the Minister of Finance to both Houses of Parliament is the main medium through which the Government pronounces its economic policies for the year. Budget preparation consists of a gruelling three month period in which the shape of expenditures and revenues for the forthcoming fiscal year is determined. Work on program expenditures begins at the National Planning Commission where each Ministry is asked to present its development expenditure plans. Intensive discussions follow before the Planning Commission forwards its final decisions to the Ministry of Finance.

At the Ministry of Finance, the focus is on recurring expenditures and revenue policy. Discussions on revenue policy start with the preparation of the Economic Survey which involves evaluation of the performance of the economy during the last nine months. A Tariff Board, with members of the private sector and the Government, is also constituted to advise the Minister of Finance on revenue policy. Concurrently, Ministry officials start formulating the revenue policy with the main actors being the Joint Secretary in-charge of revenue policy, the Director Generals of the various tax departments, and the Economic Advisors.

The IMF gets into the budget act about six weeks before final presentation. A team from Washington visits Nepal and examines the proposals and revenue estimates being considered. Their normal concern was whether the proposals were in line with the ESAF agreement. Sensitive to public opinion, the visitors always emphasized that it was Nepal's budget and not the IMF's.

process? Consider this: it was usual practice for a group of high-level Nepali policymakers to cloister around a television set and follow Indian Finance Minister Man Mohan Singh's Budget Speech carefully just in case immediate policy decisions had to be made. Similarly, during budget preparation at the Ministry of Finance, the initial focus was always on the levels of tariffs and subsidies in India and the extent to which the forthcoming Nepali budget had to counter them. Moreover, because India's budget came a full four months ahead of Nepal's, the strategy pursued by the Ministry of Finance was to stay at least a year ahead of India's policy initiatives. This was important for both economic and political reasons: economically, Nepal had to stay in sync with Indian policies to maintain export competitiveness, to prevent flight of capital, and to check the flow of unrecorded trade; politically, it had to be shown that Nepal could occasionally lead the way rather than always tow India's line.

Political Will

While initiating reform is one thing, sustaining the process is quite another. We have witnessed many examples in the recent past, including that of Russia and Eastern European nations, where countries have initiated economic reform because of economic compulsion but have retreated with the passage of time. Conceptualizing and initiating reform is easy. The hard part is pursuing them over the long haul.

Our experience in Nepal is that "political will" was a necessary pre-condition for sustained economic reform. What do we mean by political will? It means having a clear vision about a set of economic objectives and exercising political leadership in pursuing that vision. It requires courage to stay the course and not be hijacked by special interest groups.

Why is political will important? Because introducing economic reform is not politically easy. Most Governments come into power promising a lot more than the country's resources can bear and policy reform--especially fiscal austerity--requires hard choices. This was typical in Nepal as well. The Nepali Congress Government came into power in May 1991 (after the restoration of democracy) preaching democratic socialism and promising populist programs. Their manifesto emphasized the need to "follow a mixed economy by establishing industries in public...sectors", "encourage and protect domestic investments", and initiate "price controls and an effective distribution system" (Banskota, 1991). But, when the Eighth Plan came out a year later, the Government had switched to "promoting a private sector led economic policy" (National Planning Commission, 1992). What happened during this period to change the entire outlook?

First, Prime Minister Koirala drafted two western-educated economists as his chief policy architects. Ram Sharan Mahat, a United Nations diplomat, was asked to be the Vice Chairman of the National Planning Commission, while Mahesh Acharya who was

pursuing higher education in Germany, was made Minister of Finance. Both these individuals had been exposed to market-driven economies and were firm believers in economic liberalization. Secondly, Koirala himself started to tour the world and saw the importance of the private sector. He asked three Asian leaders to describe, in one word, the cause for the rapid growth of their economies. The leader of Thailand said "quick decision", Indonesia "political will", and Singapore "education." Clearly, exposure to global conditions had a lot to do with the political determination to initiate economic reform programs in Nepal. Thirdly, the Nepali Congress was blessed with a comfortable majority in Parliament and Koirala felt that politically unpopular decisions that required trading short-run pains for long-run gains could be best done in the first three years of his tenure.

At what level does political will have to exist for sustained economic reform to take place? The simple answer: the higher the level at which the commitment exists, the better the chance of sustaining reform. Take the case of privatization of public enterprises in Nepal. Minister of Industry Ram Krishna Tamrakar created numerous stumbling blocks during the privatization proceedings. He was especially opposed to the sale of Bansbari Leather and Shoe Factory to Leather Age India, an Indian firm which was also the sole valid bidder. His intransigence was starting to derail the entire first phase privatization program. It was then left to Prime Minister Koirala to call a special meeting at his residence to overrule his own Minister and proceed with the privatization process⁴. Similar situations existed in other privatization programs. We found Minister of Agriculture Ram Chandra Poudel, a senior member of the Cabinet, more hesitant to privatize the Nepal Tea Estate and the Dairy Development Corporation than Radha Krishna Mainali, the CPN-UML representative to the High Level Privatization Committee. As a result, privatization proceedings for these two agricultural enterprises were slowed down considerably despite commitments at the very highest level. By the time Poudel was willing to accept a compromise that suited his socialistic leanings, mid-term polls were announced, stalling the entire proceedings.

Numerous other examples exist. While drafting a new legislation for Company Law, the Minister of Industry objected to various provisions in the law that engineered a liberal environment, including establishment of a one-person company by a foreign investor. Repeated requests from other Ministries and bureaucrats did little to get the Minister to budge. It mattered little to him that the country already had an Industrial Enterprise Act that promoted liberal provisions and allowed 100 percent foreign equity participation. It was again left to the Prime Minister and the Finance Minister to coax the Minister of Industry in accepting the new legislation and having it readied for tabling in Parliament.

⁴ During the meeting--attended by the Minister of Finance and Chief Secretary Damodar Gautam, but absconded by the Minister of Industry--, Koirala let it be known that his decision to go ahead with privatization was to be considered equivalent to a Council of Minister approval.

The importance of political will was perhaps made more transparent following the accession of the CPN-UML to power. Reform efforts during their tenure were slow in coming. And this despite the issuance of a white paper by the Government which largely mirrored policies of the previous Nepali Congress Government. Why was reform sluggish in taking-off? Largely because the stated economic policies in the white paper were vastly different than the policies in their Election Manifesto (Communist Party of Nepal, 1994). This variance in views created conflicts within the Communist Party that made it difficult to pursue reform at the previous pace. Privatization of public enterprises was one such example. The Government was caught in a dilemma between providing greater autonomy to the enterprises and assigning political appointees to the Board of Directors. Ultimately, the latter prevailed in practice. This made it easy for the Economic Liberalization Project to terminate, in March 1995, its assistance on privatization.

Bureaucratic Commitment

The importance of bureaucracy to the reform process should not be minimized. They represent the first line of defense that need to be tackled to get the reform process going. If high-level bureaucrats who have access to political appointees cannot be convinced of the need for reform, no amount of effort can sustain the process.

Our experience has been that a few technocrats or bureaucrats well-placed in the Administration and reasonably well-versed about the reform process have to take the lead. In the case of Nepal, three technocrats--P.R. Ligal, Member of the National Planning Commission and Chairman of the PDC, T.N. Pant, Secretary of Finance, and H.S. Tripathi, Governor of the Nepal Rastra Bank--were crucial to sustaining the reform process. These three represented the core of economic policy decision-making administration in the country. Without co-ordination among these three and their institutions, reform would not have been possible. They took the lead in designing policy changes, and were supported in implementation by their deputies, Nirmal Pandey at the National Planning Commission, Govind Thapa at Ministry of Finance, and Satyendra Pyara Shrestha at the Nepal Rastra Bank. If these six could not be convinced about the need for reform, the going was going to get extremely tough.

Why were these institutions and actors important? Because, in the context of Nepal, the National Planning Commission, the Ministry of Finance, and the Nepal Rastra Bank represent super agencies not necessarily engaged in line Ministry activities. It was, therefore, relatively easy for them to advocate fiscal discipline and deregulation. The line Ministries, on the other hand, were turf conscious and hesitant to liberalize their own sectors, even though there were individuals at these Ministries, especially at Industry, who were strong advocates of reform. In one instance, we were unable to convince the Ministry of Information to deregulate cinema hall ticket prices even though the country had already deregulated macro variables such as foreign exchange

and interest rates!

Bureaucratic culture and its nuances are important to understand in the policy-making process. Our experience has been that bureaucrats are not very co-operative in implementation of policy if they have not been taken into confidence from the very beginning. A case to point was with revision of Company law. The Secretary of Law and Justice Ved Vyas Chettri thwarted many attempts made by the Ministry of Industry to table in Parliament a revised version of Company law. His up-front argument was that there was no need to bring a new legislation when only 34 of the 110 provisions were being changed. The real reason, we were to find out later, was that the Ministry of Law and Justice was not represented in the Policy Dialogue Committee that initiated the legislation drafting. On another initiative--Build-Operate-Transfer (BOT) legislation--where officials from his Ministry were involved from the start, Chettri's co-operation was complete.

Bureaucratic commitment is likely to be strong and the process of reform a lot more sustainable when decision-makers feel a sense of national ownership. If countries are forced into reform, the actual implementation gets very difficult. In the case of Nepal, the Eighth Plan--which promoted a private-sector led economy--preceded the Extended Structural Adjustment Facility (ESAF) arrangement with the International Monetary Fund (IMF). And yet, much of the criticism on structural reform in Nepal concerned the IMF's alleged high handedness in pushing economic liberalization. The two annual ESAF's missions that came to Nepal, one just before the Budget, contributed a lot to this image of donor dominance.

Despite allegations of donor interference, our experience has been that the

Bureaucratic Nuances

High-level bureaucrats are a very tight group, especially in a closed society like Nepal. This can be both a blessing and a curse. Take the case of the Value Added Tax (VAT), for instance. Secretary of Finance T.N. Pant was of the strong opinion that the ELP assisted VAT Project should reside in his Ministry. P.R. Ligal, who initiated the program through recommendations of the ELP funded Policy Analysis Wing at the National Planning Commission, felt that the VAT taskforce should come under his convenorship. Both being friends--and later partners in a consultancy firm--were uncomfortable to talk about it. They preferred evasion, forcefully arguing against each other was difficult for fear of personal offense. After months of delay, it was left to ELP to work out a solution acceptable to both.

ESAF Arrangement

The Extended Structural Adjustment Facility (ESAF) arrangement was signed between the Government of Nepal and the International Monetary Fund (IMF) in September 1992. It is a three year agreement that required the Government to meet specified macroeconomic targets by September 30, 1995. Important among the targets were: reduction in the Government deficit to 8.75 percent of GDP in FY 1994/95, average annual growth of GDP of 4.5 percent, inflation rate of 5.0 percent, and increase in revenue mobilization from new measures equivalent to 0.5 percent of GDP each year. Accompanying these targets were a series of reform initiatives that touched on all sectors of the economy. Achieving these targets and policies meant releases of two tranches of funds from the IMF to the Nepal Rastra Bank. The ESAF team visited Nepal twice annually to check on progress regarding the targets and policies.

momentum for reform in Nepal emanated from within the system. The tranche funding associated with the ESAF agreement was never considered enough of an incentive to either pursue or ignore the macroeconomic targets set. T.N. Pant, former Secretary of Finance who brokered the arrangement, often told us that ESAF was agreed to for maintaining internal fiscal discipline and not for pleasing donors. And while Arun-III has often been mentioned as the source of conditionality, it is worth noting that much of the Arun discussions followed and not preceded the ESAF arrangement⁵. How convinced were high-level Nepali bureaucrats about the need for reform? When the CPN-UML came into power, it was they who faced Communist Party officials and repeatedly argued for the need to continue with the reform process. This is not easy in a country like Nepal where political coloring is often put on those not subscribing to the ruling Party's ideology.

Technical Know-how

Competent and well-prepared technical groups are needed to design sensible reform programs and ensure effective enforcement. Such technical know-how can be acquired either from within the system or outside. In Nepal, very little technical expertise existed within the country in contemporary areas of structural reform⁶. As such, donor assistance had to be resorted to. The Policy Dialogue Committee of the Economic Liberalization Project was the vehicle through which the Government of Nepal was able to acquire technical know-how, both domestic and foreign. ELP's technical assistance to the Government of Nepal encompassed a wide range of activities, from general policy advocacy to specific sectoral assistance.

Technical assistance, from our experience at the Economic Liberalization Project, was important to the reform process in four respects. First, such expertise was used as a sounding board for possible reform initiatives. We found many instances where the Government, at its own initiative, sought donor technical advice on policy directions. This was--difficult as it may be to believe--true with tax reform, banking reform, and foreign exchange convertibility issues. We also found that, in many instances, if the donors did not push for reforms agreed to, it would be difficult for the host country to follow through with it politically. The Government, in many cases, might be aware of the right policy to pursue but did not have the stomach to follow through with it. Bureaucrats, in those situations, used the IMF ESAF agreement as the excuse for going ahead with the reform.

⁵ Arun-III, a \$764 million hydro-power project, was killed by the World Bank on August 4, 1995 after almost a decade of preparations and negotiations (Spotlight, 1995a). While Arun required implementing ESAF conditions, ESAF itself was only tied to tranche funding.

⁶ Even when domestic expertise existed, the Government often did not have the financial flexibility to acquire their services.

Second, in the absence of technical assistance, the Government would have found it difficult to push ahead with reform. This was especially true in the context of new initiatives like the Value Added Tax, establishing a trading floor at the Stock Exchange, and legal reform. The technical expertise to implement the reform just did not exist in Nepal, and it was necessary to bring expatriate advisors to help out in these activities. In all cases, however, it was important that the foreign consultants worked with local experts to ensure sustainability of the initiative.

Third, donor technical advisors were a effective means of pushing the Government on implementation of reform programs. We found the Government a lot more responsive to expatriate experts, partly because they bring money with them. In many cases, the Government simply would not get serious about implementing reform until an expatriate advisor landed in town to start working on the subject matter. Often, with expatriate advisors in town, the Government was forced to make decisions on whether implementation was to be seriously considered. We found this to be true on many occasions, especially with the Value Added Tax.

Technical assistance was also important in convincing the Government what not to do, or indicating that the time may not be right for the initiative proposed. Keeping up with the Jones's was at times too closely adhered too. There was, for instance, great pressure on the Government to consider off-shore banking in Nepal. At the request of the Nepal Rastra Bank, ELP ultimately had to fly-in a consultant to tell policymakers that Nepal did not have the proper political and economic infrastructure to introduce off-shore banking at the moment. We found the same to be true for credit rating service. Nepali policymakers, worried about a collapse in the capital market, wanted to initiate a credit rating bureau to rate equity issues. Rating equity issues was a misconception on credit rating that we had to rectify through an expatriate consultant.

IV. Factors Impeding the Reform Process

Thus far, we have highlighted our experiences in describing elements that contributed positively to the reform process. But, this does not imply that all was well with Nepal's policy reform initiatives. From time to time, we ran into many hurdles that slowed the pace of reform. Some of these obstacles came early in the process, while others much later. Our focus now turns to some of the major factors that impeded the process of policy reform in Nepal.

Political/Administrative Instability

Nepal is set to have its third general elections in just over four years. After the restoration of democracy in 1990, the first general elections was held in May 1991 with the Nepali Congress coming to power with a thumping majority. Less than three

and a half years later, in November 1994, another general election was held following internal feuding within the Congress Party. A hung Parliament ensued, with the Communist Party of Nepal forming a minority Government. Six months into the new Government, King Birendra accepted the recommendation of Prime Minister Man Mohan Adhikari for dissolution of Parliament and set new general elections for November 1995.

This period of four years provided us with a gamut of experiences on the effects that political stability can have on various aspects of public administration, including policymaking. And, our observation is that increases in political instability is perhaps the most damaging impediment to the country's development process. Instability destroys the very foundations of decision-making at all levels of bureaucracy and business. The situation is especially alarming in a country like Nepal where bureaucracy is so tainted with political ideology that even rational decision-making can be viewed with suspicion.

Political stability is a pre-requisite for sustained policy for a number of reasons. For one, policy reform involves many unpopular decisions, and unless a country has political stability, it is very difficult for the Government to pursue economic liberalization. In the case of the Nepali Congress Government, a comfortable majority in Parliament allowed it to make unpopular decisions associated with the reform agenda. Privatization of public enterprises was being pushed despite political opposition, Value Added Tax was being pursued despite resistance from the business community, and fertilizer subsidies were being reduced despite protests from politicians from within the ruling Party. The Finance Minister, in the budget

speech for FY 1993/94 noted, "politically, economic reform is a risky proposition that could undermine our popularity...we could continue with subsidies, launch unsustainable projects, and provide unproductive employment. But this will not foster sustainable development...and the economy will become vulnerable from within.... Our goals may be difficult but our direction is certain...." (Ministry of Finance, 1993). By contrast, the CPN-UML Government came into power as a minority Government with another mid-term poll looming. Consequently, the policies enunciated by this Government in the Ordinance Budget for FY 1995/96 was replete with populist

Mid-term Polls and Reform

When the Nepali Congress Government asked me in the Spring of 1994 to extend my stay in Nepal for an additional year to complete some of the policy initiatives our project had started, I voiced my concerns regarding the possibility of mid-terms polls and its effect on economic reform. Having been assured that early elections were unlikely, I decided to stay. A few months later, a mid-term poll was announced. For about six months after that, the administration came to a virtual halt: policy decisions were not being made and the atmosphere was not congenial for economic reform. The CPN-UML Government that came to power following the mid-term poll also suggested that I extend my stay for another year. But, by then, a second mid-term poll had already been announced for November 1995, and our experience from the past made my decision to leave easy. If Nepal's economic reform process is to be sustained, the voters will either have to elect a majority government or learn to live with a coalition regime.

programs: price subsidies, pension to the aged, and hand-outs to villages and Members of Parliament. Very little concern was shown towards realistic revenue generation or fiscal austerity. Short-term programs designed to influence the next elections seem to be the order of the day; sustaining the process of policy reform was put on the back-burners (Ministry of Finance, 1995).

Political instability also affects a country's ability to attract foreign investments. More than 50 percent of the foreign investors that came to Nepal in the last twenty years was in a period of 36-months starting July 1991. Following the announcement of mid-term polls in July 1994, foreign investments have slowed down considerably (Nepal Society for Applied Economics, 1995). A capital and technology poor country like Nepal cannot sustain the reform process without flows of funds and technical know-how from overseas. This stoppage in foreign investments has other ancillary effects: because Nepali policymakers appeared more willing to make policy and procedural changes based on foreign investor concerns rather than those of domestic business, pushing the reform agenda gets more difficult without foreign investments. Not surprisingly, it was almost two years after the implementation of the one-window business registration system for foreign investors that similar measures were considered for domestic firms.

When Governments change so does administration: Nepal does not have a culture where bureaucracy is left untouched with political realignment. Hence, stability in bureaucracy becomes an element in the reform process. We experienced numerous instances where changes in bureaucracy made it difficult to sustain the reform process. On Company Law, for instance, the transfer of PDC member Bhola Chalise from the Ministry of Industry made the going very difficult, despite an equally market-oriented replacement. Two changes in the Secretary of Supplies slowed down considerably our attempts to introduce Consumer Protection Legislation. With each change, administrative decisions were being deferred and it was necessary to re-educate the concerned individuals so that s/he could be the engine of advocacy for the reform program.

Inability to Communicate

Economic reform has to be broad based and convincingly communicated for it to attain sustainability. The communications effort, it appears to us, has to come on a number of fronts. For one, the Government should be able to convince its own policymakers of the relevance of reform. In Nepal, we found the Nepali Congress Government struggling to assure a majority of its own Parliamentarians and Party members that the philosophy of state-dictated socialism was passe. For instance, neither the Minister of Industry nor Chiranjibi Wagle, who was later to become the leader of the "Rebel Group of 36" that contributed to the collapse of the Nepali Congress, were really sold on the Privatization Act introduced by their own Government. The latter, as a member

of the Lower House Finance Committee, sided with the Opposition to stall the Bill. And, rather than engineer a consensus on the relevance of reform, the Nepali Congress political leadership used its clout and Parliamentary majority to hammer home the agenda. The process was very different with the CPN-UML Government. The Government and Party officials held numerous debates before coming to a consensus on their economic policy white paper. In one instance, discussions on the economic white paper went past midnight at the Prime Minister's residence. But once consensus was reached, all towed the Party line.

Reform has also to be publicly acceptable for it to attain sustainability. In the case of Nepal, not much was done to educate the public and bring about a strong national consensus on the reform process. Privatization of public enterprises (PEs) is a point in case. Despite one of the most successful privatization programs in South Asia, the Government found itself always hounded with criticism. Two of the most often heard criticisms were under-valuation of assets and sales to foreigners (Indians). And yet, all ten privatized PEs were sold at values considerably higher than those assessed by professional appraisers⁷. On the issue of sales to foreigners, only one (Bansbari Leather and Shoe Factory) of the ten firms was sold to a non-Nepali. And in this, the Government had very little choice: the only valid offer came from Leather Age India, an Indian firm (Sharma, 1995).

Creating a coalition with business is a pre-requisite for a sustainable reform process: non-compliance by business makes the effort very difficult. Two examples on tax reform are worth noting. When the Eighth Amendment to the Income tax Act was introduced, it was done without consultations with the business community. As a result, during implementation, the problems were immense. The business community were up in arms about provisions on tax deductions and the role of auditors. Changes had to be subsequently introduced much to the chagrin of the Government. With the Value Added Tax (VAT), the process was exactly the reverse. A lot of complaints were initially heard about the tax. But most of these came from a misunderstanding of the concept. Once the misgivings were resolved following meetings with various business chambers, the resistance was a lot less⁸. In fact, the VAT Task Force was later able to get lobbying help from exporters and other businesses, such as hotels and shoe manufacturers, who perceived benefits from the tax. It seemed a lot more judicious to take the heat early and arrive at a consensus rather than face the possibility of a stalled reform effort later.

⁷ Ironically, after coming into power, the CPN-UML Government used the same Nepali appraiser whose professional work they had questioned earlier.

⁸ This does not suggest that businesses were all in support of the VAT. In a crude poll conducted by the IRIS office for the FY 1995/96 Ordinance Budget, only 20 percent of businessman supported immediate implementation of the VAT (Highlights, 1995).

Institutional Rigidities

We will define institutions in the broad sense of the term where it includes any set of legislation, rules and regulations, and administrative infrastructure that would enhance the economic performance of a country (Bossert, 1994). Hence, our definition of institutions would include such diverse activities as advancing legislation, simplifying rules and regulations, strengthening administration, and upgrading infrastructural facilities.

Much of our early work in Nepal focused on two aspects of institutional reform: simplification of rules and regulations for business registration and advancing legislation associated with economic decision-making. We found the lack of transparency in rules and regulations an imposing impediment to the reform process. Decisions were being made by a closed-door group whose decision-making process was not known. There was wide discretion in decisions, resulting in allegations of favouritism and corruption (Cohen, 1995). Through a local study we were able to show that it took almost six months to get a business registered; the equivalent time in the U.S was one day. It was in this context that IRIS worked with the Government to introduce and simplify the one-window system for foreign investors.

We also found the legal system archaic, unpredictable, and unreliable, and envisioned that unless the legal institutions in the country could be advanced, the process of economic reform could not be sustained. Hence, we were keen to assist the Government with revision of Company Law. Subsequently, the legal reform effort was to include modification in Contract law, and initiation of Consumer Protection and the Build-Operate-Transfer (BOT) legislation.

Our focus turned to institutions in the capital market after the Government introduced legislation that split the Securities Exchange Centre into the Securities Exchange Board (regulator) and the Nepal Stock Exchange (market). We supported the Exchange set up a Trading Floor and helped the Board with training programs for participants in the capital market. In addition, we also assisted both these capital market institutions draft rules and regulations.

How much of an impediment has institutional rigidities been to the economic reform process? Let us first start with the laws of the land. Thanks to the legacy of the British Raj in India, Nepal too had emulated many of the legal and judicial institutions that are needed for market reform. Hence, Nepal was already a market-driven society where traditional concepts of property rights, the judicial system to arbitrate those rights, and the administrative mechanism to implement legislation existed. It was, therefore, unlike in the former Soviet Union and East European countries where the concept of property and individual rights, privately-owned enterprises, and the administration to enforce rules and regulations did not exist. Rather, Nepal's problem

was that the legislation so developed where archaic, out of step with the modern economy, not business friendly, and promoted rent seeking. The existing Company Law, for instance, makes no distinction between publicly held companies and private companies: the same rigid standards apply to both, raising considerably the transactions costs to the latter. Similarly, business risks to companies are high because the prevalent Contract Law does not have adequate legal provisions for arbitration, redemption, or enforcement. Consequently, our effort was to improve the efficacy of the system by upgrading laws and legislations.

Moreover, we found the rules and regulations that supported the various legislations lacking in transparency and clarity. Rules and regulations were deliberately muddled to increase the discretionary authorities of bureaucrats and raise the possibilities of rent-seeking. Businesses, for instance, continually complained about the definition of movable property in the wealth tax. Similarly, income tax deduction at source was defined to include all entrepreneurs, including taxi drivers and small vendors. And, the concept of "burden of proof" was so vaguely written in the Finance Act that the Minister of Finance, in exasperation, redrafted the language himself in the FY 1994/95 Ordinance Budget.

It also did not help that adhocism in decisions made a mockery of rules and regulations. Exemptions were granted by the Council of Ministers in defiance of bureaucratic norms and recommendations. A point in case was the import tariff exemption for equipment purchased by the cable firm Space Time Network. Repeated arguments made by the Ministry of Finance that such exemptions to an individual firm would promote unfair competition was rejected by Koirala's Council of Ministers. Adhocism also became the rule of the game with the Communist Government. The practice of tendering for bids was sidelined and contracts awarded to firms and individuals without transparent procedures (Cohen, 1995). In one instance, a Canadian bank refused to honor the letter of credit for fertilizer purchase awarded to a firm through a non-competitive basis, delaying arrival and creating panic among agricultural producers (Spotlight, 1995b). Clarity in procedures was also missing in the sale of reserve shares of the Seti Cigarette Factory (Deshantar Saptahik, 1995). Even though the Government could have made a premium by bidding on those shares, the Board of Directors of the parastatal company sold it at par value to an individual. What was worse is that the previous Government had already initiated the bidding process for the shares.

While adhocism in decisions did not help, the absence of rules and regulations made the situation worse. It seemed a lot easier to have legislation passed in Parliament than have bureaucracy design rules and regulations needed to implement those laws. This led to a situation where the Government could publicize its reform efforts whereas businesses continually complained about the lack of effectiveness of the policies enunciated. For instance, with the Finance Leasing Act, the bureaucracy was simply

ill-equipped to formulate relevant rules and regulations. Hence, when a South Korean investor wanted to set up a joint-venture leasing firm, none in bureaucracy knew where to start. When the Korean firm volunteered to help write the rules and regulations, the Government--suspicious of their motives--refused the offer.

But, even in cases where rules and regulations existed, the administrative structure was so inefficient (fragile) that implementation was difficult. Rent-seeking was excessive and it was in the bureaucracy's interest to thwart any reform initiatives. The low pay structure in Nepal did not help, and with deterrence costs low, the incentive to buck the system was great. Moreover, because bureaucracy is heavily politicized and subject to frequent transfers into or out of "lucrative" assignments, the incentive to "make hay while the sun shines" was great. Lower levels of bureaucracy did not have a sense of ownership about the reform process. And, one unconvinced bureaucrat could easily scuttle the entire process. We ran into this in many instances. Despite the political leadership's zeal to go ahead with custom's administration reform, the initiative could not go beyond the discussion stage at the Ministry of Finance. Many interest groups would have been affected by such a reform, and bureaucrats at the Ministry were vehement in their opposition to it⁹. Similarly, Nepal's one-window policy for foreign investors is well-crafted. But, ask any entrepreneur about the ease of starting new business, and you will be told of a litany of problems related to transparency in procedures, discretionary authority of officials, and inconsistency in interpretation (Dhungel, 1994). "Time money", defined by a high level bureaucrat as graft given to speed up paper processing, is essential to get the system going. Indeed, if there is one problem that will continue to haunt Nepal's move towards a private sector led market economy, it is the Government's inability to carry lower levels of bureaucracy with it. Economic reform that is not accompanied by administrative reform will be difficult to sustain.

Rules of the Game and Bureaucracy

How twisted can bureaucracy get? Consider this: during the early 1990's, Nepal was starting to import a large number of "re-conditioned" Japanese cars. These are old vehicles that are re-done and sold to poor markets like Nepal. Since these contribute more to pollution than newer vehicles, the Ministry of Finance imposed additional customs duties on older cars to discourage imports. It was only later that we found out that Customs authorities were using discretionary judgement in interpreting the law. Brand new vehicles imported by diplomats and sold in the local market (when departing) were considered re-conditioned. It mattered little to customs authorities that these diplomatic vehicles had pollution free stickers approved by the Department of Transportation.

⁹ Much of the rent-seeking in customs is through discretionary valuation of imported goods. To check this, we proposed on numerous occasions the need to introduce a pre-shipment inspection system. But, customs officials steadfastly refused to entertain such a notion.

V. Lessons in Policy Making

There are two issues involved when talking about reform: the substance of reform and the process of reform. The substance of reform, as indicated earlier, has been addressed in a paper elsewhere (Dixit, 1995) where we talk about the various measures that the Nepali Government might pursue to further the economic liberalization agenda. This paper, on the other hand, focuses on the process of reform, concentrating more on how reform may be brought about rather than when reform is possible. We are, therefore, more concerned about the lessons learnt in sustaining the process rather than those necessary for initiating the process.

National Ownership

The most important lesson we learnt is that the drive for policy reform has to come from within the system. There has to be unwavering belief among key policymakers that the policy changes to be introduced are in the best interest of the country. The process of economic reform is laced with numerous hurdles, and a lot of inertia has to be expended to overcome the coalition of political opposition and administrative lethargy that block significant changes. Even the best-laid plans will come to naught unless key political and administrative figures are involved in the planning from the beginning. It is imperative that key policymakers, decision-makers, and technocrats are comfortable with the proposed changes and are willing to bear the torch of economic liberalization from inception to completion.

Participatory approach to policymaking--where the Government took the lead with technical back-stopping from donor agencies--is the best means for creating ownership. It was in this context that we found the Policy Dialogue Committee of ELP to be extremely useful. The Committee, in its own little way, provided a forum in which high-level decision-makers could sound out their ideas on policy changes and have it discussed among peers, including donor representatives. Many of the ideas that were discussed at the PDC were good and were followed through, but there were others--such as off-shore banking and credit rating--where the time was not right. Nepali policymakers were willing to acknowledge the latter when told so by experts. The key, we found, was to ensure that the ideas were initiated from within the system. Once this

Selling Reforms to Politicians

How one sells reforms to policymakers is very important. We as economists often tended to use economic logic to pursue a reform agenda. But, it soon became clear to us that politicians are more easily convinced using political arguments. When Prime Minister Koirala was briefed about the need to introduce full convertibility of the Nepali Rupee for current account transactions, a purely political argument (pre-empt India) was found to be more effective. Similarly, we were able to dissuade the Government from pursuing off-shore banking by citing the political pressures (parallel economy issues) that may be put on Nepal by neighboring countries concerned about wealth declaration of their citizens.

occurred, the initiator turned into an activist for the proposed policy change and his/her consistent effort was the best hope for introducing change.

Policymakers others than those in or closely associated with the Government should be taken into confidence when designing policies. This should be the case irrespective of whether the Government enjoys a Parliamentary majority or not. Our project, in drafting legislation on Company law and Consumer protection, included members of the CPN-UML Party in the team. Consequently, when the Communist came into power, they were willing to go along with both legislation. The reform process, therefore, was a lot more acceptable. But, this does not mean that politicians will not alter their stance when faced with a different political climate. Ram Sharan Mahat, Vice-Chairman of the National Planning Commission in the Nepali Congress Government and Shadow Minister of Finance while in the Opposition, told us that he would oppose any attempts to lower or eliminate the minimum fixed capital requirement of Rs. 20 million on foreign investments if the Communist Government were to bring it up for a vote in Parliament. It mattered little to him that initial discussions on modifying the legislation were carried out while he was in office; the political benefits he could derive from opposing such a "anti-nationalist" measure far exceeded the rationality of economic logic.

Broad-based Appeal

For economic reform to be successful on a sustained basis, it has to be broad based and acceptable to the masses. Li (International Herald Tribune, 1995) points out that the opposition to reform was minimal in China because the country reformed its economy from the bottom up, starting with agriculture. In 1994 in China, there were nearly 19 million township and village enterprises employing 113 million workers. In India, on the other hand, just 6 million people depend on the industrial sector that has been the focus of reform and the political opposition therefore is considerable. Nepal's situation is similar to that in India: less than 15 percent of the GDP is derived from the manufacturing sector which has been the focus of economic reform.

Under such circumstances, economic reform which involves unpopular decisions may have to be accompanied by other measures that would be more palatable to the public. Investments in infrastructure, health, education, and rural services program are often a part of such measures. But equally important, there is a need to decentralize authority at the village or township level so that people at the grass roots feel a part of the development process. The Communist Government that followed the Nepali Congress regime, for instance, introduced the "Build Your Village Yourself" program under which lump sum money was offered to each village unit to be used for developmental purposes at their own discretion. While there exists problems in the procedures and implementation mechanism, the concept itself has been very broadly accepted. A public opinion poll (Highlights, 1995) indicates that more than two-third

of the public approves of it.

Pork barrel politics will always be a part of economic policymaking. This is the reality in the U.S. Congress, the Japanese Diet, and the Indian Parliament. Take the case of India: in July 1995, Prime Minister Rao, with an eye on the impending general elections, introduced a \$1.3 billion program of pension for the aged, school lunches for students, and life insurance for villagers. Similarly, it was not that the Nepali Congress Government planned to be altruistic: discussions had taken place about the need to introduce populist measures in the fourth and fifth years of their regime after the fiscal situation was brought within acceptable limits. But, the key issue is how one funds these programs without crowding out other investments. It is, in this context, imperative that populist programs be non-distortionary and be linked to the reform process. Such programs should be budget (deficit) neutral and financed through revenues generated from additional measures.

Broad basing also means creating coalitions for reform that include the business community. Too often in the past in Nepal, Government policy changes were introduced unilaterally without consulting with the business community. In the new economic democratic society we live in, this will be difficult to sustain. It is also important to understand that business consultations are not for political convenience. There should be a genuine give and take where all classes of businesses are taken into confidence. Listening only to the big boys may not necessarily be in the interest of increasing competitiveness.

The other element of broad-basing economic reform is having proper public relations. Nepal's privatization program was one of the most successful in Asia (Cohen, June 1995); yet, the Government was never able to take advantage of this to push the reform agenda even further. Accusations about undervaluation of assets and sale to Indians proliferated by different political parties hindered the pace at which privatization could have been pursued. Yet, when the Communist Government came into power, they adopted many of the same procedures and practices used by the Nepali Congress Government. The lesson is clear: there is a need to use mass media and other social marketing techniques to create a significant constituency to support reform. The concept of political "spin doctors" used in the U.S. might be something that the Nepali Government might seriously consider.

India Complex

Many Nepalis have an India complex much like most small countries have against larger neighbors. This, at times, seems to affect rational thinking. Nepalis prefer foreign investments but not necessarily those from India. They feel Nepali laborers have the right to work in India but not vice-versa. The benefits that a large market like India can provide is acknowledged but not without reservations. Unless Nepal can empower itself economically, this inferiority complex vis-a-vis India will remain.

Consistency in Implementation

Consistency in implementation of policy has to exist from the top down. Adhocism in decision-making makes a mockery of rules and regulations. The discipline has to start from the Council of Ministers. If exemptions are to be provided for certain interest groups, this should be applicable to all. The Government should not be in the business of providing competitive advantage to one business vis-a-vis another; it should be promoting a level playing field. The tariff exemption to the Space Time Network, as cited earlier, was not very judicious going as it did against the recommendations of the concerned Ministry. Similarly, the tendency of late to award contracts without competitive bidding should be actively discouraged. The notion that graft money taken in the name of a political party is acceptable has to be changed. What is even more disturbing is the attitude of many businesses on graft money. During the Tariff Board discussions on the FY 1995/96 Ordinance Budget, the proposal to allow tax deductions on contributions to political parties was ardently opposed by some members representing the business community. It is difficult to promote transparency in decision-making when both business and Government prefer secrecy in dealings.

Corruption and Decision-making

Local papers are full of stories on corruption charges against high-level decision-makers. Examples include tariff exemptions to a cable network, license granted to a local businessman for imports of levy sugar from India, fertilizer purchases from Canada, and sale of various public enterprises. These are all accusations that are, of course, very difficult to verify. But, businesses told us that when projects are awarded to them, a certain amount of money often changes hands in the name of the ruling "Party". This money, if used for Party purposes, is not necessarily viewed as evil by Nepali society. However, because Party finances are never made public, this lack of transparency is often the source of corruption charges.

Implementation at the administrative level has been Nepal's biggest lacuna in the economic reform process. It was with this in mind that the Economic Liberalization Project, during its third year in existence, turned its attention from policy advocacy to institutional reform where simplification of rules and regulations was the focus. It was clear to us that the policy reform agenda was at variance with the administration's willingness to implement. Hence, that which looked good on paper was never properly executed. Rent-seeking bureaucrats, particularly at lower levels of administration, were consistent hurdles to the reform process. This was especially the case with income tax administration. Despite numerous attempts in the various budget speeches to make the system more transparent, income tax authorities were able to find loopholes to harass taxpayers. The burden of proof, it seemed, always lay with taxpayers rather than with tax authorities. This problem is not likely to go away as long as deterrence costs are low and tax offices are evaluated on the basis of annual revenue targets set for them by the Ministry of Finance.

The inability of the Government to provide employees with an incentive based system combined with the lack of authority to hire and fire within the framework of a private sector culture contributed to the problems of implementation. Low pay and difficult retrenchment laws made such behaviour disguisedly acceptable. The Government was cognizant of this and was focusing in bringing about changes in the capacity of implementing organizations through changes in structure and organizational chart issues. But, administrative reform was not able to cope with the pace of policy advancements. Moreover, bureaucratic culture itself was not willing to change. It is, therefore, not necessarily privatization that is important to Nepal; rather it is the private sector work culture that has to be ingrained. This, to some extent, also applies to the private sector as well where societal relationships often define business practices rather than purely business principles (Rothenberger, 1995).

Donor Participation

Our experience in the Economic Liberalization Project is that there are four basic lessons on policy reform from a donor perspective. Firstly, donor involvement in some form is almost a necessity for the policy reform process to proceed. Decades of experience--from the Marshall Plan to the growth of the Asian tigers--will testify to this. But, while donor assistance is necessary, conditionalities and technical assistance should come from a mutually respectable negotiating process. This mutuality existed in Nepal with the IMF in the ESAF agreement as well as the participatory approach on technical assistance espoused by the Economic Liberalization Project.

We also learnt that donor co-ordination is an important element for sustaining reform for a number of reasons, the most important being that resources are scarce and duplication of efforts implies inefficiency. Moreover, because host Governments often tend to shop around for assistance to ameliorate conditionalities involved, donor co-ordination would guard against this tendency. This shopping for assistance occurred for the second phase of the privatization program, banking reform vis-a-vis the Rastriya Banijya Bank, and capital market development in the context of the Nepal Stock Exchange. In some cases, the Government was able to exploit the schism among donors, in others not. Donors need to be on the same page so as not to be taken for a ride.

In addition, donor assistance should be used to create internal advocacy groups. Technical assistance is necessary for pushing the reform agenda, but is not sufficient in itself. Internal advocacy is necessary for sustaining the activity. There are many ways of creating advocacy groups. In the case of privatization and tax reform programs, we used training programs in the U.S. to develop such groups. Similarly, advocacy groups were developed for other policy initiatives by having local contractors take the lead doing necessary ground work for relevant studies. Later, it were these

individuals that were the core advocates of privatization, tax reform, and other policy reform initiatives.

Finally, donors themselves should be consistent in their strategy. Host Governments often complain about donors agreeing to assist, and pulling out later with one excuse or another. USAID, for instance, went out of its way to support Nepal's liberalization program. But, as Washington's strategy changed, USAID/Nepal's commitment got weaker. This hurt the economic liberalization program. Negotiating technical assistance with another donor can take considerable time and effort: the least that donors can do is to co-ordinate a strategy to minimize the damage.

VI. Conclusion

The primary objective of this paper was to use our experience to point out factors that have been important to the policy reform process in a small-country case like Nepal. Our experiences were based on the Economic Liberalization Project of USAID that assisted Nepal with numerous policy initiatives, including tax reform, privatization of public enterprises, capital market development, and legal reform. Not all of these initiatives have been carried to fruition, and experiences at different stages of the reform process have been used to develop this paper.

We point out that compulsion brought on by economic liberalization in India was an important element in initiating the policy reform process in Nepal. The introduction of partial convertibility of the Indian Rupee for current account transactions opened the flood-gates of economic liberalization in Nepal, especially in the trade sector. India's economic moves are followed very closely in Nepal, and the latter's strategy has been to try to stay one step ahead of its huge southern neighbor's policy initiatives.

Political will, in our experience, was perhaps the most crucial element in sustaining the reform process once economic compulsion made it necessary. And, in Nepal's case, political will was buttressed greatly by the exposure that key decision-makers had to global conditions and realities. Similarly, bureaucratic commitment has been crucial to the sustenance of reform, and it appears to us that unless a core group of well-connected technocrats are willing to design sensible programs and push the reform agenda ahead, the best laid plans can come to naught.

The changes in Government in Nepal during the last twelve months provides a glaring example of the importance of the relationship between political stability and the pace of reform. With a majority Government, the Nepali Congress was able to push policy measures that were politically unpalatable but necessary for long-term economic growth. With a minority Communist Government that is preparing to go for mid-term elections, the focus has shifted to populist measures to win electoral votes. Unless

Nepal can come up with a stable Government in the forthcoming elections, the process of reform will be difficult to sustain.

Among other factors important for reform, we point out the relevance of a contemporary, predictable, and reliable legal system. A poorly functioning legal system raises uncertainty and increases the costs of doing business. Similarly, transparency in rules and regulations are also important in lowering rent-seeking and creating a congenial business atmosphere. Besides, foreign investors are unlikely to enter a country that is riddled with bureaucratic inefficiency. And, without foreign inflow of capital and technical know-how, the process of reform will be hard to sustain.

Technical assistance, especially from expatriates, is also cited as a must at the initial stage. Without such assistance, the country may not have enough expertise to design and implement a sensible program of reform. Such assistance can be greatly reduced in the later phase when local expertise is built. This was the case with privatization of public enterprises in Nepal.

The lessons learnt from the policymaking process were many. Our experience was that host country nationals should have a strong sense of ownership of reform. Policy prescriptions that are forced upon by donors are difficult to sustain. We point out the reform process did not come to a halt even after the Communist Party came into power. A sub-set of bureaucrats that helped initiate the process during the previous regime were the activists for further work. In this context, participatory policymaking is most likely to be sustainable.

Broad-basing reform is also crucial to the sustenance process. Because policy reform involves many unpopular decisions; it may have to be complemented by measures that would catch the public's fancy. Investments in the social sector as well as certain populist programs might be needed. It is, however, important to ensure that such programs are non-distortionary and budget (deficit) neutral. They should be financed through new measures designed to raise additional revenue and in the spirit of economic liberalization.

Another lesson that we learnt is that it is not privatization per se that is important but rather the private sector culture. An incentive based system where hiring and firing is permitted should be introduced in Government. No degree of transparency in rules and regulation can match the rent-seeking skills of bureaucrats unless deterrence costs are high. The economic literature is replete with examples that show that crime is an economic activity where the criminal weighs the costs and benefits of committing the act.

Donors have a very crucial role to play in the reform process. Conditionalities and

technical assistance should truly come from a mutually respectable negotiating process. A second-best solution proposed by the host country has a better chance of implementation than a first-best solution that is imposed. Advocacy is welcome, but not imposed advocacy. Donor co-ordination too is a must to preserve scarce resources and avoid the tendency for aid-hopping. And, donors should try to stick with their commitments and not change strategy in mid-stream: do on to others as you would have them do on to you.

The policy reform process in Nepal is relatively young and has provided us with many lessons and corrections to look forward to. Presently, Nepal is at a cross-road, stuck between economic liberalization and populist electoral promises. The hope is that a majority Government will ensue during the forthcoming elections and push even harder the process of reform. The challenge, however, is daunting: populist measures once introduced are difficult to revoke. Will the next Government, in the interest of the country, have the courage to discount short-run costs for long-term gains?

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